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Joint venture companies: practical problems of their organization and corporate governance

Joint venture companies, being one of the forms of doing business, despite the sanctions and the tense political situation on the world stage, continue to enjoy certain popularity in Russia. Foreign investors are actively investing their money, knowledge and experience in domestic business, together with Russian partners, are opening various companies and enterprises in various sectors of the economy. There are many reasons for this, the main of which are gaining access to new commercial markets, and the ability to produce new types of goods and services.

The desire of foreign investors to invest in the Russian economy and carry out business activities on our territory, to implement various projects has led to the fact that joint venture companies have become the most common form of foreign direct investment, facing its problems in terms of organization and corporate governance.

The main regulatory source of regulation of joint venture companies in Russia is the Federal law dated 09.07.1999 N 160-FZ "On foreign investments in the Russian Federation" (hereinafter – the Law on foreign investments). This law establishes the national legal regime for the activities of foreign investors, i.e. the regime under which foreign investors enjoy the same rights and obligations on the territory of our country as Russian investors.

The result of the rules on the national legal regime is the participation of joint venture companies in business activity on an equal basis with domestic ones, except for those individual restrictions that are established by Federal laws, including the Federal law of 29.04.2008 N 57-FZ "On the procedure for foreign investments in economic societies of strategic importance for national defense and state security".

In addition to the legal regime, the Law on Foreign Investments also provides various guarantees and preferences for foreign investors (guarantees of compensation for nationalization, guarantees against adverse changes in legislation or “grandfather's reservation”, etc.). But the Law on Foreign Investments does not directly regulate the organization of activities and corporate governance of joint venture companies, referring in this part to the general provisions of civil law.

Therefore, along with the Law on Foreign Investments, the Civil Code of the Russian Federation, as well as the Federal Law of 08.02.1998 N 14-ФЗ “On limited liability companies” and the Federal Law of 26.12.1995 N 208-FZ “On joint-stock companies. "

It is important to note that until recently, domestic legislation regulated corporate governance issues both in joint venture companies and in Russian organizations only with the help of general norms and principles of civil law. The parties entered into corporate agreements, relying not on legislative norms, but on the principle of freedom of contract and dispositive relations.

Only in 2009 in connection with the adoption of the Federal Law of 30.12.2008 N 312-FZ “On Amending Part One of the Civil Code of the Russian Federation and certain legislative acts of the Russian Federation” and the Federal Law of 03.06.2009 N 115-FZ “On amendments to the Federal Law “On joint-stock Companies” and article 30 of the Federal Law “On the securities market”, the institution of a corporate contract was enshrined in existing law.

These laws provided for the possibility of resolving corporate issues and issues related to the organization of activities of business companies using agreements on the exercise of the

rights of members of the company and shareholder agreements. The introduction of such changes was a big step forward, because, as the law enforcement practice of that time showed, including the judicial one, corporate governance issues needed a certain legal guideline and legal regulation.

Large-scale reform of civil legislation in 2014 consolidated the amendments, as it was, among other things, marked by the introduction of the concept of "corporation" in the Civil Code of the Russian Federation and a separate article that regulates the issues of a corporate agreement in sufficient detail.

The changes introduced by the Federal Law of 08.03.2015 N 42-FZ “On Amendments to Part One of the Civil Code of the Russian Federation” also had a favorable effect on the development of domestic law: concepts such as conditional fulfilment of obligations, assurance of circumstances were introduced into Russian civil law, option contract, option, etc., which have always been mandatory elements of a corporate contract from the point of view of foreign law and order.

With the introduction of amendments, the legislation somewhat balanced the correlation of the concepts of “corporate contract” and “charter”. Russian corporate law has always preferred the provisions of the charter over the provisions of corporate contracts. The courts recognized the corporate agreement as completely invalid if certain of its provisions were in conflict with the charter (See, for example, the ruling of the Ninth Arbitration Court of Appeal of 02.11.2014 in case No. A40-97313 / 2013). Now, due to the introduction in 2014 of Article 67.2 of the Civil Code of the Russian Federation, in particular, paragraph 7 of this Article, only certain conditions of a corporate agreement can be recognized as invalid. Moreover, if the provisions of the corporate agreement contradict the terms of the charter, which are imperative, then such provisions may be invalidated, if the corporate agreement contradicts the dispositive rules of the charter, the parties are not entitled to dispute the agreement on this basis.

However, despite all this, in practice, there are still and will be problems of organization and corporate governance of joint venture companies, the main of which is to address the following issues:

- Preparation of Memorandum of intent and choice of legal form;
- Choice of law applicable to legal relations between the parties;
- Selection of a body to resolve disputes between the parties;
- Formation of governing bodies.

Preparation of Memorandum of intent and choice of legal form

First of all, when creating the joint venture company, such issues as the preparation of a memorandum of the intent of the parties (agreement on the procedure for negotiating) and the choice of the legal form of the enterprise are subject to resolution. In the memorandum of intentions, future partners record initial and prospective agreements: the size of the parties' participation in the authorized capital of the joint venture company, the procedure for distributing the profits of the enterprise, the timing of specific actions to create the enterprise, applicable law and much more.

The conclusion of a memorandum of intent in Russian law is regulated by Article 431.1 of the Civil Code of the Russian Federation, devoted to negotiations on the conclusion of an agreement. According to paragraph 4 of Article 431.1 of the Civil Code of the Russian Federation, one of the means of securing certain aspects of negotiations is an agreement on the procedure for negotiations. By such an agreement, the parties can specify the requirements for fair negotiations, establish the procedure for the distribution of costs for negotiations and other similar rights and obligations. In the context of joint venture companies, the memorandum of intent represents agreements on the negotiation process.

The selection and approval of the legal form of the joint venture company are also advised to carry out at the initial stage of negotiations because the further organization and management of the enterprise depends on it.

Domestic legislation can offer a foreign investor a sufficiently large number of legal forms: business partnerships, business companies, production cooperatives and others.

However, the vast majority of joint venture companies in practice are created in the form of business companies - limited liability companies and joint-stock companies. Of course, this is due to the fact that participants in business companies are not liable for their obligations with their property. At the same time, the advantages of business companies for creating joint venture companies lie in the organization of their activities and corporate governance. So, the conclusion of a corporate contract, as the main mechanism of corporate governance, is possible only for limited liability companies and joint-stock companies, based on the content of paragraph 1 of Article 67.2 of the Civil Code of the Russian Federation.

The choice of law applicable to the legal relations of the parties

The participants in the joint venture companies, guided by the principle of autonomy of the will of the parties, enshrined in Russian law in Article 1210 of the Civil Code of the Russian Federation, at the conclusion of a corporate agreement, as well as subsequently, they can choose by agreement between themselves the law that is subject to application to their rights and obligations under this agreement. This is an absolute plus in the legal regulation of the organization of joint venture companies because the parties can subordinate their relations to that law, which will be most beneficial for them, taking into account the specifics of their business and business goals.

At the same time, this plus has an important nuance, which consists in the fact that the choice of the law to be applied to the agreement on the creation of a legal entity and to the agreement related to the exercise of the rights of a participant in a legal entity (corporate agreement) cannot affect the effect of imperative norms of law country of the place of establishment of the legal entity on the issues specified in paragraph 2 of Article 1202 of the Civil Code of the Russian Federation.

Here, for example, it is worth noting the resonant decisions in the cases of MegaFon JSC (Joint Stock Company) and Russian Standard Insurance CJSC (Closed Joint-Stock Company), in which the courts recognized corporate contracts invalid because of a contradiction to imperative norms (See, for example, the resolution of the Federal Antimonopoly Service of the West Siberian District dated March 31, 2006 No. F04-2109 / 2005 (14105-A75-11), Decision of the Moscow Arbitration Court of 12/26/2006 in case No. A40-62048 / 06-81-343).

The imperative norms of domestic legislation include the norm that internal relations, including relations of a legal entity with its participants, which should be understood as corporate relations, are determined in accordance with the personal law of the legal entity, i.e., the law of the country where it is established the entity.

Thus, on the one hand, Russian law allows the application of foreign law to a corporate contract, and on the other hand, it creates a risk that the court may recognize certain provisions of the contract and actions in accordance with these provisions not corresponding to the imperative norms of the legislation of the Russian Federation (See, for example, Resolution of the Arbitration Court of the North-Western District of 03.02.2016 in case No. A56-41197 / 2014).

Selection of a body to resolve disputes between the parties

One of the guarantees of the rights of foreign investors who make investments in the joint venture companies in Russia is the possibility of transferring disputes arising with the participation of Russian partners to domestic state courts or to commercial arbitrations (arbitration courts).

Foreign investors often prefer that disputes with their participation be considered and resolved by commercial arbitration. In each case, this is due to its own reasons, which generally boil down to mistrust in the system of Russian state courts and the desire to ensure the confidentiality of corporate disputes.

However, prior to the 2016 arbitration reform, the possibility of transferring corporate disputes was very uncertain. The uncertainty lay in determining the boundaries of the arbitrability of corporate disputes since the regulation of arbitrability was unsystematic. On the one hand, corporate disputes could be the subject of arbitration in accordance with the wording of the law. On the other hand, decisions of higher courts established restrictions in this part (See, for example, the determination of the Supreme Arbitration Court of the Russian Federation dated January 30, 2012, in case No. A40-35844 / 2011-69-311)

The arbitration reform resolved this uncertainty. From February 1, 2017, it became possible to refer most corporate disputes to commercial arbitration. So, based on the content of paragraph 2 and 4 of Article 225.1 of the Arbitration Procedure Code of the Russian Federation, corporate disputes related to the creation of a legal entity, its management or participation in a legal entity, with the exception of those in which, in the opinion of the legislator, a public interest is clearly expressed (disputes about convening a general meeting of participants in a legal entity; disputes, related to the exclusion of participants in legal entities, etc.) may be referred to the arbitration court if there is a valid arbitration agreement between the parties to the dispute. In this case, the arbitration agreement on the transfer to arbitration of all or part of the disputes of the participants of the legal entity created in the Russian Federation and the legal entity itself, for the consideration of which the rules of arbitration of corporate disputes are applied, according to paragraph 7 of Article 7 of the Federal Law of December 29, 2015 N 382-FZ “On Arbitration (Arbitration) in the Russian Federation” may be concluded by including it in the charter of a legal entity.

It is also important to consider that corporate disputes can be referred to arbitration courts only subject to a number of conditions, namely:

- a legal entity, all participants of a legal entity, as well as other persons who are plaintiffs or defendants in these disputes, have entered into an arbitration agreement on the transfer of these disputes to the arbitration court
- arbitration proceedings will be administered by a permanent arbitration institution
- the arbitration institution approved the rules for the consideration of corporate disputes;
- the place of arbitration is the Russian Federation

Formation of governing bodies

Current legislation provides greater freedom to business entities in matters of forming governing bodies and determining their competence. For example, participants in the joint venture company may appoint several persons authorized to act on behalf of a legal entity without a power of attorney, i.e. may appoint several directors. Moreover, in such cases, directors can act both independently of each other, and jointly in accordance with paragraph 3, part 1, Article 53 of the Civil Code of the Russian Federation. In this way, a balance of interests of the participants in the joint venture company and their protection can be ensured.

Now, in order to ensure the rights and interests of foreign investors, as participants in joint venture companies, a special procedure may be established for holding a general meeting of participants, taking into account the specifics of the presence of some of its participants outside the territory on which the joint venture company is located.

When resolving issues related to the formation of governing bodies, it is important to know and remember that these issues cannot be agreed upon by the participants in the joint venture company in a corporate agreement because of paragraph 2 of Article 67.2 of the Civil Code of the Russian Federation. The structure of enterprise governing bodies and the competence of such bodies can only be determined within the framework of the charter of a legal entity.

In conclusion, it is worth to note that despite the need to resolve all the above issues when creating joint venture companies, which cannot always be solved within the framework of domestic legislation in accordance with the desires and goals of foreign investors, despite the large decline in foreign direct investment in the Russian economy in 2018, despite international political differences, joint venture companies remain and will remain the most popular and profitable form of investment.